

Proceeding: **IN THE MATTER OF DEPLOYMENT OF WIRELINE SERVICES OFFERING A** Record 1 of 1
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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matters of)
)
Deployment of Wireline Services Offering)
Advanced Telecommunications Capability)

CC Docket No. 98-147

**INITIAL COMMENTS OF THE
TECHNOLOGY ENTREPRENEURS COALITION ("TEC")**

I. Introduction

The dictionary defines entrepreneurs as those people "who organize a business venture *and assume the risk for it.*" In any business venture, however, if a firm perceives that the risks of a proposed business venture will outweigh the financial benefits, then entry simply will not occur. Similarly, if a firm has already entered a market and then subsequently decides that the risks outweigh the benefits of continuing in this business, then this firm might seek to exit the market through merger or consolidation, thus reducing – and not adding to – the amount of additional alternatives in the market. Investment in telecommunications and information services is, by its very nature, a highly capital and time intensive venture. Accordingly, if the Commission truly wants to accelerate the "arrival [of] broadband communications services of the twenty-first century"¹, then the Commission must understand any entry decision will depend on

¹ *In re Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 98-187, ____ FCC Rcd ____ (rel. Aug. 7, 1998) at ¶ 1.

whether a rational firm perceives that it will reap sufficient financial rewards from pursuing a strategy focusing on developing and selling advanced infrastructure and advanced services and products to offset any offsetting existing (and potential) risks and costs to its current business.

On August 7, 1998, the Federal Communications Commission (“FCC” or “Commission”) issued a sweeping Notice of Proposed Rulemaking (“NPRM”) in this proceeding designed to help accelerate the deployment of advanced telecommunications capability – and, in particular, new infrastructure development – to all Americans pursuant to Section 706 of the Telecommunications Act of 1996.² While the NPRM covers a broad range of issues, TEC’s comments are limited exclusively to the viability of the Commission’s voluntary structural separation proposal as set forth in paragraphs 85 through 117 of the NPRM.

II. Discussion

A. *What Policy Objective is the Commission Really trying to Achieve in this Proceeding?*

In this Notice of Proposed Rulemaking, the Commission has proposed a rather draconian yet potentially very pro-competitive regulatory *quid pro quo*. Basically, the Commission proposes to permit an ILEC to sell “advanced telecommunications services”

² *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability, et al.*, Notice of Proposed Rulemaking, ___ FCC Red ___, FCC 98-188 (rel. Aug. 7, 1998).

and, more significantly, *interstate exchange access services*, on a wholly unregulated basis so long as the ILEC agrees to form, and sell such advanced and interstate access services exclusively through, a structurally separate affiliate. The motivating idea behind this proposal is to somehow entice the ILEC to unbundle voluntarily its *entire* local loop from its retail marketing business, such that the transaction-cost economics come more in line with promoting competition, not monopoly³ – *i.e.*, so long as the owner of the loop has to sell a key input to its competitors, then it has absolutely no incentive to do so willingly; but if that same company is engaged exclusively in the loop business (and not in the business of selling to the end user), such that it has no incentive to restrict access to competitors, then that company is going to be motivated to sell as many loops as it can to as many buyers as it can.⁴ Anything short of this market structure, however, simply perpetuates the unsatisfying *status quo*.⁵

Accordingly, just like the Notice of Inquiry (NOI) issued concurrent with this proceeding, the legal question under Section 706 is extremely discrete – *i.e.*, will the Commission's proposal accelerate the deployment of advanced telecommunications infrastructure and services? After reviewing the specific details of the Commission's proposal in this NPRM, TEC believes that the Commission's proposal is unlikely to

³ See generally, Oliver Williamson, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (The Free Press 1985).

⁴ See Jerry B. Duvall, *The Evolution of Competition in the Market for Local Telecommunications Services: A Proposal for Industry Organization in the 21st Century*, presented before "Survival Strategies for the Future: Planning for Change and Consolidation" sponsored by United States Telephone Association (June 28, 1987).

⁵ See, *e.g.*, the experience with the Rochester NY "unbundling" plan.

motivate incumbents to voluntarily disaggregate *all* of its retail business from their network business, because the economic costs required by the Commission's plan may prove to offset, if not actually outweigh, the economic benefits the ILEC would receive by pursuing such a strategy.

B. *What's in it for the ILEC?*

As the NPRM makes clear, success for the Commission's proposal is predicated on voluntary acceptance by the ILEC. Thus, the key question to ask is whether an ILEC – just like the analysis that any other lawful business would make – will perceive that the benefits of the Commission's proposal will outweigh any perceived costs. On one hand, the possibility of providing advanced telecommunications services and interstate exchange access service is a very enticing carrot. These are very profitable markets, and the ability to adapt and innovate quickly to competitive exigencies is quintessential to any firm's success.⁶

On the other hand, however, it is also very important to recognize that the structural rules imposed by the FCC will have significant economic costs.⁷ Among the

⁶ See *In re Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd. 5880 (1991) at ¶ 80 (finding that when there is no economic nexus between regulations imposed and current market conditions, regulation can have a variety of adverse effects on market performance, including, *inter alia*: (1) denying a firm flexibility to react to market conditions and customer demands; (2) regulatory delays and uncertainty which reduce the value of a firm's service offerings; (3) affording competitors advanced notice of another firm's price and service changes which fosters a "reactive market, rather than a proactive one," and thus reduces the incentives for firms to "stay on their competitive toes"; and (4) negating, in whole or in part, a heavily-regulated firm's incentive and ability to become a "first-mover" in the market).

⁷ See *Antitrust, the "Public Interest" and Competition Policy: The Search for Meaningful Definitions in a Sea of Analytical Rhetoric*, ANTITRUST REPORT (Matthew Bender, December 1997) (http://www.phoenix-center.org/library/neo_comp.doc) at 8, n. 36 (explaining that "[s]tructural separation is not a homogenous regulatory or antitrust enforcement tool. Rather, like all forms of economic regulation,

most significant of these costs are how the NPRM proposes to severely restrict, if not outright prohibit, the various types and degree of existing assets that an ILEC may transfer to the unregulated affiliate (especially the ultimate prize – the local loop).

Similarly, because many states have denied ILEC requests to set up unregulated affiliates that sell bundled voice and data, barring a clear statement from the Commission that it would pre-empt such rules, the FCC's proposal similarly holds little promise of permitting an ILEC affiliate to bundle voice and data on an unregulated – albeit structurally separated – basis.⁸ Thus, in its attempt to “level the playing field” by forcing the ILEC's affiliate to buy loops on the same terms and conditions as other competitors, the Commission may have inadvertently over-shot its target by making, in effect, the ILEC's unregulated affiliate “less than equal” by making its competitors “first among equals.”⁹

structural separation is question of degree: the stricter the regulatory requirement of ‘separateness,’ the higher the cost to the regulated firm.”)

⁸ As TEC argued in its Section 706 NOI comments, the Commission unfortunately has a “less than aggressive” track record for using its pre-emption authority to promote competition under Section 253 of the 1996 Act.

⁹ As TEC explained in its initial comments, TEC has absolutely no desire for the FCC to use this proceeding to find new ways either to “level the playing field” or to promote “fair” competition because it simply and improperly reduces competition to a “zero-sum game.” (citing, Frank Easterbrook, *The Court and the Economic System*, 98 Harv. L. Rev. 4, 39 (1984) (those “who see economic transactions as zero-sum games are likely to favor ‘fair’ divisions of the gains and losses”); John Berresford, *Future of the FCC: Promote Competition, Then Turn Out the Lights?* 21-22 (Economic Strategy Institute, May 1997) (because the “playing field is never ‘even’ to begin with . . . bringing in a lot of regulatory landscape architects and earth-moving equipment will, in most cases, only postpone the emerging competition and the benefits it would bring to consumers.” Thus, once regulators start to level the playing field to be “fair” to one competitor, “all the other competitors will find something unfair to them and will want their valleys to be filled and their mountains and hills to be brought low. The process can become an endless one and, if carried to its logical conclusion, makes the regulator into a cartel manager. This guarantees jobs for the regulators, lawyers and lobbyists, and oligopoly for the so-called competitors, but it will do little for consumers.”)

Given the above, what revenue-enhancing benefit does the FCC's proposal really set forth for the ILEC? As demonstrated above, the costs seem to equal (and probably in the minds of some actually outweigh) the economic benefits from voluntarily accepting the Commission's proposal. Moreover, as the FCC readily admits, there is absolutely nothing stopping an ILEC from providing advanced services on an integrated – yet regulated – basis.¹⁰ Thus, so long as the incumbent perceives that the FCC's proposal will add no affirmative benefit to its bottom line, then the incumbent is simply going to pursue the traditional strategy of "if it ain't broke, don't fix it."

III. Conclusion: How Only New Entry Can Tip the Scales in Favor of Voluntary Disaggregation of Loop and Retail Businesses

In sum, whether the Commission's unregulated separate affiliate proposal will help accelerate the deployment of advanced telecommunications infrastructure and services will depend ultimately and exclusively on the cost/benefit analysis conducted by the various strategic planners and bean-counters within each ILEC. This decision, however, is for the ILEC alone to make, and it is therefore appropriate for neither the

¹⁰ See NPRM at ¶ 86. Indeed, PacBell has stated unequivocally in very major recent public announcements that it has now made xDSL available to 5 million customers in 180 markets in CA. See PacBell Press Release, "Pacific Bell's ADSL-Internet Access Packages Now Available To 180 California Communities: Company Delivering On Promise To Provide Communities With High-Speed Data And Internet Solutions To More Than 5 Million California Residential And Business Customers" (San Francisco, California, September 1, 1998). Similarly, Sol Trujillo, president and CEO of US West, stated publicly and explicitly that US West decided *six years ago* to pursue a data-centric strategy, explicitly outlined the nationwide in-place scope of their endeavor (out of region in combination with Intermedia); identified dozens of markets where they claim to have rolled out xDSL to date; and specifically highlighted Phoenix where broadband over xDSL is fully available and where in fact it has requested non-dominant status. See Interview with Sol Trujillo by Steve Rosenbush, USA Today at Telecom Business '98, New York, NY (Sept. 2, 1998) (<http://www.uswest.com/com/insideusw/webcast/090298.html>). Accordingly, given the *market realities*, perhaps the FCC's initial query should be to ask why further regulatory relief/restructuring is needed in the first instance, since clearly to date the market – by the Bells' own

Commission nor any other party to this proceeding to make this decision in a vacuum for them *in absentia*. Accordingly, if the Commission wants to tip the scales in favor of its voluntary proposal – such that a true, structurally separate “loopco” market structure materializes¹¹ – then the FCC must affirmatively and aggressively reduce regulatory barriers to infrastructure entry such that competitive pressures – rather than regulatory enticements – will force the ILEC to unbundle voluntarily its network business from its retail business.¹²

Indeed, as TEC argued in the NOI, the Commission should not promote “competition” for competition sake. While the ability to choose among a variety of providers is certainly better than a choice of only one, *so long as everyone is scrambling over the same incumbent-owned constrained capacity*, the process of improving the current poor market performance does not move forward – *i.e.*, the market does not need another “competitor” just for the sake of “another” competitor, *what the market needs are more loops to mitigate the incumbent firms’ dominant control over key inputs of*

admissions – has provided sufficient impetus for (claimed) mass rollout. Like it or not, neither the Commission nor the ILECs can have it both ways.

¹¹ See Duvall, *supra* n. 4.

¹² Indeed, what the Commission wants to replicate is the AT&T/Lucent voluntary divestiture experience, rather than the flawed “unbundling” attempts currently underway in the U.S. electric utility industry where, because FERC consistently fails to get the transaction-cost economics correct, no one is building any new transmission capacity, prices continue to rise, and consumers increasingly suffer from power blackouts. See *Utility Entry Into Telecommunications: Exactly How Serious Are We?* PHOENIX CENTER POLICY PAPER SERIES, POLICY PAPER NO. 1 (July 1998) (<http://www.phoenix-center.org/pcpp/pcpp1.doc>); *Three Reasons Why Utilities Need Telecommunications Expertise – Whether They Like it or Not*, INFRASTRUCTURE, American Bar Association, Section of Public Utility Law (Spring 1998) (http://www.phoenix-center.org/library/3_reasons.doc); see also See Jerry Duvall, *Entry by Electric Utilities into Regulated Telecommunications Markets: Implications for Public Policy*, PHOENIX CENTER FOR ADVANCED LEGAL AND ECONOMIC PUBLIC POLICY STUDIES POLICY PAPER SERIES (Forthcoming Winter 1998).

*production!*¹³ Accordingly, for the reasons set forth in TEC's initial comments to the Commission's Section 706 NOI, TEC contends that despite the Commission's laudable goal in this proceeding, until the Commission identifies and rectifies the various policies that inadvertently deter, rather than accelerate new entry, any efforts (public and private sector alike) devoted to achieving the structural separation proposal set forth in this NPRM simply will have no meaning.

Respectfully submitted,

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¹³ To wit, adding one more competitor (*i.e.*, the ILEC's unregulated affiliate) to a market currently characterized by rivalrous competition will do little to affect, *pro or con*, overall consumer welfare. Moreover, because it is unlikely that the ILEC's affiliate will not be able to bundle voice and data to consumers (and *a fortiori* satisfy their ephemeral and utopian desire for "one stop shopping"), it is unlikely that the presence of this on firm will help increase and consolidate sufficient demand for an "alternative distribution provider" ("ADCo") to enter the market and construct additional loops. See George Ford, *Interconnection Policy and Consolidation of Non-Incumbent Demand for Alternative Infrastructure*, presented before Global Interconnection Forum for Telecoms, Barcelona Spain (Sept. 16, 1998).